

**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554**

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| In the Matter of |) | |
| |) | EB Docket No. 03-197 |
| Section 272(d) Biennial Audit of |) | |
| BellSouth Telecommunications, Inc. |) | |

**COMMENTS OF AT&T CORP. ON BELL SOUTH'S SECTION 272
COMPLIANCE BIENNIAL AUDIT REPORT**

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Pursuant to the Commission's Public Notice in the above-entitled matter,¹ AT&T Corp. ("AT&T") hereby submits its Comments on the Report of PricewaterhouseCoopers LLP (the "Auditor"), filed on December 23, 2003 in connection with the biennial section 272 audit of the BellSouth companies ("Auditor's Report").

INTRODUCTION AND SUMMARY

In light of the Supreme Court's recent *Trinko*² decision, aggressive enforcement of the Telecommunications Act obligations by the Commission is more important than ever before. In *Trinko*, the Supreme Court substantially curtailed antitrust remedies for anticompetitive behavior by the BOCs, reasoning that under the comprehensive regulatory framework of the Telecommunications Act, the Commission is responsible for identifying and prohibiting

¹ See Public Notice, *BellSouth Telecommunications Inc Section 272 Biennial Audit Report*, EB Docket 03-197, (Jan. 9, 2004).

² *Verizon Communications Inc. v. Law Offices of Curtis V. Trinko*, 124 S. Ct. 872 (2004).

anticompetitive conduct by the BOC.³ While the Telecommunications Act may have granted the Commission the ability to police and penalize anticompetitive conduct by the BOCs, the Commission regrettably has failed to do so, confusing deregulation with the abdication of its authority.

Congress expressly provided in section 272(d) that a BOC operating a section 272 affiliate “shall obtain and pay for a joint Federal/State audit every two years” to determine whether the BOC has complied with section 272 and the Commission’s rules. This Congressionally-mandated audit is the primary means by which the Commission can test compliance with the requirements of 272 that Congress and this Commission have deemed so vital to competition in *all* telecommunications markets. Yet, as AT&T has chronicled in its Comments on prior section 272 audits, the section 272 audit process has been progressively weakened through dilution of audit standards and procedures and through the Commission’s weak enforcement in the face of material violations uncovered despite the woefully inadequate audit procedures.⁴

After *Trinko*, the Commission must assume its statutory obligation to conduct a thorough and meaningful section 272 audit and to penalize violations in order to protect the public from the abuse of market power identified in the section 272 audit. Continued Commission inaction after *Trinko* will only encourage those “regulated” monopolies in a position to use regulatory

³ *Id.* at 881 (“One factor of particular importance is the existence of a regulatory structure designed to deter and remedy anticompetitive harm. Where such a structure exists, the additional benefit to competition provided by antitrust enforcement will tend to be small, and it will be less plausible that the antitrust laws contemplate such additional scrutiny”).

⁴ Comments of AT&T Corp., CC Docket 96-150, at 3-6, 11, 13-15 (filed Apr. 8, 2002); (“AT&T First Verizon Audit Comments”); Comments of AT&T Corp., CC Docket 96-150, at 1-6, 32-36 (filed Jan. 29, 2003); (“AT&T First SBC Audit Comments”); Comments of AT&T Corp., EB Docket No. 03-200 at 1-4 (filed Feb. 10, 2004) (“AT&T’s Second Verizon Audit Comments”) at 2-3 and 6-7.

processes to leverage their market power to quash emergent competition in the local market and to re-monopolize the long distance market.

There is clear and dispositive evidence of section 272 violations uncovered by this audit despite its shortcomings.⁵ Indeed, the audit provides clear evidence of discriminatory conduct. For example, the BellSouth long distance section 272 affiliate, BellSouth Long Distance (“BSLD”), enjoyed more timely installation than non-affiliates for DS1 and other special access services, especially in Georgia, Louisiana and Florida. BSLD also had materially lower trouble rates than non-affiliates throughout the region for most of the engagement period. The BellSouth BOC, BellSouth Telephone (“BST”) also steered over half its small business callers to BSLD. Indeed, a review of the script used by the BOC customer representatives suggests that in fact all callers were steered to BSLD.

The audit also provides evidence of cost misallocation by BellSouth. This most certainly was the case with respect to Operations, Installation & Maintenance (“OI&M”) services, which were provided to BSLD by a non-section 272 BellSouth affiliate, BellSouth Carrier Professional Services (“BCPS”). Provisioning of OI&M services by BCPS was a clear violation of the Commission’s rules that “bar a BOC or any BOC affiliate, *other than the section 272 affiliate itself*, from performing OI&M functions associated with the facilities that its section 272 affiliate

⁵ In its previous Comments, AT&T identified shortcomings such as: (1) eliminating procedures included in the proposed model audit requirements which were the subject of a public notice issued by the Commission in 1977, Public Notice, 12 FCC Rcd. 13132A (1997), but never acted on by the Commission; (2) eliminating procedures found in the *General Standard Procedures* used in prior audits; and (3) failing to use the Joint Competitive Industry Group Proposal Regarding Performance Metrics and Installation Intervals for Interstate Special Access Services submitted in the *Special Access Docket*, CC Docket No. 01-321. *See e.g.*, AT&T’s Second Verizon Audit Comments at 3, n. 4 and 6.

owns or leases from a provider other than the BOC with which it is affiliated.”⁶ Moreover, BCPS was paid not only by BSLD but it was also paid \$4.5 million by other BellSouth companies. The Auditor never evaluated, let alone determined, whether this \$4.5 million payment was fair value for services rendered to the other BellSouth entities, or whether services were in fact ever rendered. Moreover, BCPS “does not charge BSLD on a per service basis.” Instead, BSLD only had to pay the difference between BCPS’ “total cost” and “the cost of providing services to other BellSouth companies.”⁷ That is, some or all of the \$4.5 million received from the other BellSouth entities could have been used to subsidize the cost of the OI&M services provided to BSLD.⁸ There were also numerous violations of the “arm’s length” transaction rules. BellSouth did not post many key agreements on its web site until up to four years after they were executed, and even then the web postings failed to make the disclosures required by the Commission’s rules.⁹

Because the Commission is the only forum remaining to protect the public from the abuse of market power by BOC monopolists, it is of paramount importance to consumers and

⁶ Public Notice, *In the Matter of Section 272(b)(1)’s “Operate Independently” Requirement for Section 272 Affiliates*, WC Docket No. 03-228, DA-03-3742, (rel. Nov. 21, 2003), ¶ 3, *citing to the Non-Accounting Safeguards Order*, 11 FCC Rcd at 21981-82, 21984-86, ¶¶ 158, 163-66; 47 C.F.R. § 53.203(a)(2)-(3). (emphasis added). *See also*, Objective I, Procedure 3, Appendix A at 1.

⁷ Objective I, Procedure 5, Appendix A at 2. The rate of return was calculated on BCPS’ total salaries and wages.

⁸ There was also a notable lack of proof regarding joint ownership of assets – no title documents were produced; only invoices. And many of those invoices were billed to BCPS which, as noted above, provided OI&M services to both BSLD and the other BellSouth entities.

⁹ The Auditor also failed to investigate fully whether these transactions were properly valued at fully distributed cost rather than fair market value. *See* Section II. B.2 *infra*.

competition that the Commission take a hard line here and confirm that it will not tolerate section 272 violations and that future section 272 audits must be much more rigorous, comprehensive and well-documented.

ARGUMENT

I. THE AUDITOR'S REPORT DEMONSTRATES PERVASIVE DISCRIMINATION FAVORING THE SECTION 272 AFFILIATE

A. The Performance Measures Used In The Audits Show Discrimination In Providing Special Access Services Used To Provide InterLATA Services

As explained more fully in the attached Declaration of statistician Dr. Robert Bell,¹⁰ the Auditor's Report uncovered discriminatory treatment in both the installation and repair of special access services that constitute clear violations of section 272(e)(1).¹¹

There were three average installation interval measures: (1) "Average Intervals – Requested;" (2) "Average Intervals – Offered;" and (3) "Average Intervals – Installation." For all three interval measures, non-affiliates in Georgia and Louisiana faced statistically significant longer intervals for DS1 service than the 272 affiliate for virtually the entire engagement period. Bell Decl. ¶ 9. BellSouth tries to dismiss these three interval measures because they will "only reflect the business decisions of the customer base and cannot be used for parity comparison."¹² But there is a standard requested due date in the BellSouth region for DS1 (and other) services¹³ and BellSouth proffers no basis for claiming that unaffiliated carriers are any more likely to seek

¹⁰ Attachment 1.

¹¹ Objective VIII, Procedure 4, Appendix A at 45. Under section 272(e)(1), a BOC must "fulfill" all "requests" by competing carriers for "exchange access" and other services under the same time standards that it provides to its section 272 affiliates.

¹² *Id.*

¹³ See BellSouth Guide to Interconnection: Interconnection Services, Issue 12f, December 11, 2003, http://interconnection.bellsouth.com/guides/leo/html/gctic001/c1_2.htm, section 1.2.3.7 (five to eight days). See generally, *id.*, section 1.2.3.

extensions or longer installation dates than BSLD. BellSouth further asserts that a fourth measure – “Percentage of Installations Appointments Met” – is more relevant. This measure, however, exhibits statistically significant disparities for DS1 service in four states: Florida, Georgia, Kentucky and Alabama. Bell Decl. ¶ 10.

Non-affiliates also consistently received much slower Firm Order Confirmation (FOC) for DS3 service in Florida and Georgia. Bell Decl. ¶ 11. BellSouth proffers three explanations,¹⁴ but nowhere explains why or how much each error contributed to the disparities in treatment. Consequently, there is no evidence to suggest that the FOC disparities in Florida and Georgia are not due to systematic problems. Bell Decl. ¶ 12.

There was even more consistent and persistent discrimination in favor of BellSouth’s section 272 affiliate with respect to repair metrics. Non-affiliate carriers consistently faced much higher “Trouble Report Rates” for DS1 in all nine states.¹⁵ Bell Decl. ¶ 8. In seven of the nine states, the non-affiliate rate for DS-1 service was higher in *every* month. *Id.*¹⁶ “Average Repair Intervals” for DS1 service for non-affiliates in Tennessee exceeded those for the section 272 affiliate for the entire engagement period. Bell Decl. ¶ 13. BellSouth’s section 272 affiliate also

¹⁴ BellSouth proffers three explanations: (i) inadvertence; (ii) that some unquantified number of non-affiliate ASRs should have been “project managed” but were not; and (iii) that in some cases subsequent FOC dates were used rather than the initial FOC date to calculate the confirmation (although automated time stamps were used that should have minimized, if not avoided this problem). Objective VIII, Procedure 4, Appendix A at 45.

¹⁵ *Id.* at 46, Table 17. Also showing BSLD experienced a lower trouble rate than non-affiliates for FGD service throughout the region for most of the engagement period.

¹⁶ *See also* Objective VIII, Procedure 4, Appendix A at 46, Table 17 (showing preferential treatment for the section 272 affiliate in Georgia for 10 months, Louisiana and Mississippi for 7 months, Florida, North Carolina and Alabama for 6 months and Tennessee and Kentucky for 4 months).

received more timely repair intervals than non-affiliates for DS1 service in Georgia during December and May and for FGD service in Florida during May.¹⁷

BellSouth tries to obfuscate this evidence of discrimination by proffering unsubstantiated data purporting to show that: (1) for 26-29% of all trouble reports, no trouble was found, and (2) 97% of the “DS1 circuit base” was “[t]rouble free” “during the twelve month period.”¹⁸ This data, even if correct, does nothing to refute the statistically significant evidence that when an unaffiliated carrier’s trouble report came into BST (at which time BST did not know whether it will be “trouble free” or not) that report was “slow-rolled” while the trouble report submitted by the section 272 affiliate was not.

B. BellSouth Has Improperly Steered Callers To The Section 272 Affiliate

BellSouth failed to comply with the section 272(c)(1) requirement that a BOC’s sales representatives must inform new customers that, in addition to the BOC’s affiliates, other carriers provide long distance services.¹⁹ The data showed that for *over 50%* (16/30) of the calls to the small business call center, the BellSouth customer service representative “did not read [the] script” and “did not inform callers” of “the list of other providers” and “of their right to choose a provider.”²⁰ The Auditor classified almost 40% (6) of those calls as “steered;” that is,

¹⁷ Objective VIII, Procedure 4, Appendix A at 47. BellSouth’s explanations were either vague and uninformative or attributed to “inadvertence.” *Id.*

¹⁸ *Id.* at 46-47 and Table 18. BellSouth notably failed to break out similar statistics for the FGD and DS3 service, nor did it define the term “circuit base” which could include inventory and/or unlit circuits.

¹⁹ Under section 272(c)(1), BOCs cannot discriminate in the “provision . . . of goods, services, facilities and information.” This is a broad and general anti-discrimination provision. First Report and Order and Further Notice of Proposed Rulemaking, *Implementation of Non Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended*, 11 FCC Rcd. 21905 (1996) (“*Non-Accounting Safeguards Order*”) ¶ 197.

²⁰ Objective VII, Procedure 6, Appendix A at 31-32 and Table 12.

“the customer service representative did not ensure the caller was appropriately informed of their right to choose a long distance provider in a timely manner during the call.”²¹ The distinction between “steered” and “did not inform” is mystifying. In reality, all those customers were “steered.” In addition, eight percent (8%) of the sampled consumer (residential) callers were also “not informed” and/or “steered.”²² Indeed, even when the script was used by the BellSouth customer service representative, the caller was “steered.” In that script, the representative simply told callers that “I can read from a list all the companies available for selection, but I’d like to recommend BellSouth Long Distance.”²³ For time-constrained callers, that would be sufficient to “steer” them to BSLD.

II. THE AUDITOR’S REPORT FURTHER DEMONSTRATES THE LIKELIHOOD OF IMPROPER COST MISALLOCATION

A. There Was Cost Misallocation As A Result Of The Clear Violations Of The “Operate Independently” Safeguards.

A separate non-section 272 BellSouth affiliate, BellSouth Carrier Professional Services (BCPS), provides OI&M services to BSLD, the section 272 affiliate.²⁴ BellSouth requested that

²¹ *Id.*

²² *Id.*

²³ *Id.*, Procedure 5, Appendix A at 31.

²⁴ Objective I, Procedure 3, Appendix A at 1. *See* Letter from Mary L. Henze, Verizon, to Marlene Dortch, FCC, CC Docket No 03-228 (Feb. 3, 2004) (resubmitting a BellSouth September 12, 2003 *ex parte* in the OI&M proceeding) that provides greater detail as to what is provided by BCPS: “planning & engineering, capacity management, translations, trouble management support, central office field support, international quality routing support network operations center (NOC) vendor management, and technical subject matter expert support.” *Id.* at 1. This is far more fulsome a “description of services” than that provided in the Auditor’s Report in Procedure 4, Appendix A at 2, Table 1, which merely repeats the category name. Simply rephrasing the category name does not comply with the *General Standard Procedures for Biennial Audits Required Under Section 272 of the Communications Act of 1934, As Amended* appended to the Auditor’s Report (“*General Standard Procedures*”) at 4 which requires a description of all services rendered by BCPS to BSLD.

the Auditor subject BCPS to a separate, modified, section 272 audit, claiming that this separate audit makes “BCPS’s provision of OI&M services to BSLD the equivalent of Section 272 affiliate providing OI&M services to another Section 272 affiliate.”²⁵ But that does not cure this arrangement’s clear violation of the Commission’s rules that “bar a BOC or any BOC affiliate, other than the section 272 affiliate *itself*, from performing OI&M functions associated with the facilities that its section 272 affiliate owns or leases from a provider other than the BOC with which it is affiliated.”²⁶ Nor does it cure the concern over “indirect” subsidies from the BOC; to the contrary, the Auditor’s Report indicates this is precisely what likely occurred here.

Specifically, BCPS provides OI&M services to BSLD, the section 272 affiliate, and to other BellSouth “affiliates.”²⁷ BCPS “does not charge BSLD on a per service basis.”²⁸ Instead, “[t]he amount that BCPS bills each month is the total cost incurred by BCPS, plus a rate of return calculated on BCPS’ total salaries and wages for the month, *less the cost of providing services to other BellSouth companies.*”²⁹ BSLD pays BCPS \$3.3 million for the OI&M services

²⁵ See Sherry Herauf and Trish Green, FCC, BellSouth’s Comments to Section 272 Agreed-Upon Procedures Engagement, appended to the Auditor’s Report (Nov. 10, 2003) (“BellSouth’s Audit Response”) at 1-2; *General Standard Procedures* at 52.

²⁶ Public Notice, *In the Matter of Section 272(b)(1)’s “Operate Independently” Requirement for Section 272 Affiliates*, WC Docket No. 03-228, DA-03-3742, (rel. Nov. 21, 2003), ¶ 3, *citing to the Non-Accounting Safeguards Order*, 11 FCC Rcd at 21981-82, 21984-86, ¶¶ 158, 163-66; 47 C.F.R. § 53.203(a)(2)-(3). (emphasis added). That “BST filed a petition for forbearance,” *see* Objective I, Procedure 3, Appendix A at 1 (emphasis added), is irrelevant. BellSouth’s petition was not filed until July 14, 2003, almost two months *after* the engagement period closed on May 23, 2003. The filing of that petition would not excuse BellSouth’s violation of the Commission’s rules before relief has been *granted* (which it never has), let alone before relief has been *requested*.

²⁷ Objective I, Procedure 5, Appendix A at 2.

²⁸ *Id.*

²⁹ *Id.* (emphasis added).

provided directly to it,³⁰ while the other BellSouth affiliates pay BCPS \$4.5 million a year.³¹ There is no indication in the Auditor's Report as to what services, if any, BCPS provides to these other BellSouth affiliates or whether the \$4.5 million reflects fair value for whatever services are rendered. To the contrary, in light of the manner in which BCPS calculates BSLD's payments, all or a significant portion of the \$4.5 million that BCPS receives from the other BellSouth affiliates appears to be nothing more than a pure subsidy for the OI&M services BCPS provides to BSLD.

BST also provided equipment test and verification services to BSLD and BCPS through the BellSouth Technology Assessment Center ("BTAC"), a department within BST.³² Such equipment test and verification services constitute maintenance services within the meaning of the OI&M restriction. That is, "maintenance services" includes the "routine checking or

³⁰ Letter from Mary L. Henze, BellSouth, to Marlene Dortch, FCC, CC Docket No 03-228 (Feb. 3, 2004) at 3. Third parties, billed through BSLD paid almost \$ 40.5 million. Objective I, Procedure 5, Appendix A at 2. The Auditor's Report states that "Management indicated that they were unable to provide us with the amount BCPS charged by service; however, we noted that BCPS charged BSLD \$43,775,791 for the aggregate amount of services provided from May 24, 2002 through May 23, 2003." Objective I, Procedure 5, Appendix A at 2. Perhaps the \$3.3 million annual billing amount in the Henze letter compared with the \$43.7 million annual billing amount in the Auditor's Report can be explained by the further assertion in the Auditor's Report that BSLD was also billed for "Provisioning, Service Assurance and Customer Care [provided] to [a] third party." *Id* at 3.

³¹ Objective I, Procedure 5, Appendix A at 2.

³² *Id.*; Objective I, Procedure 5, Appendix B at 66. *See also*, Objective V/VI, Procedure 8, Appendix A at 25 (identifying this testing as improperly capitalized and when expensed, the entry was \$76,514). BellSouth Affiliated Services Corporation ("BASC") provided limited R&D "retainer" services to BSLD, with the potential for consultations on MPLS data architecture, voice over IP trials, and Advanced Intelligent Network capabilities, although the consultations did not occur during the audit period.

diagnostic testing of network elements . . . and their component parts to detect potential problems before a failure occurs,” and “repair or replacement of defective equipment.”³³

The Auditor’s Report also notes that BCPS was billed for assets used to provide services both to the BellSouth affiliates and BSLD. As a threshold matter, in auditing compliance with the joint ownership prohibition, the Auditor was not provided with “title and/or other documents which reveal ownership” as required by the *General Standard Procedures*,³⁴ but rather with invoices,³⁵ a recurring problem in the section 272 audit process.³⁶ Second, only 30% (29/94) of the sampled invoices had been properly billed to the section 272 affiliate.³⁷ The incorrectly billed invoices were from “the same vendors that also sell assets to other BellSouth entities”³⁸ and most were billed to BCPS (42/51 or 80%),³⁹ the entity that provided OI&M services to both the section 272 affiliate and to other BellSouth entities. BellSouth’s explanation for this pervasive erroneous misbilling was the catchall “clerical error.”⁴⁰

³³ Letter from Dee May, Verizon, to Marlene Dortch, FCC, OI&M Forbearance Proceeding, CC Docket No. 96-149 (June 24, 2003) (redacted version) at 2 (repair of plug-in cards by a non-272 affiliate using a BOC’s testing equipment and the repair of plug-in cards identified as OI&M violations); Letter from Paul S. Fiera on behalf of SBC, to Marlene Dortch, FCC, Forbearance and Modification Proceeding CC Docket No. 96-149, 98-141 (October 21, 2003) (redacted version) at 5 (including Maintenance Testing Center” services as OI&M services).

³⁴ *General Standard Procedures* at 23.

³⁵ Objective I, Procedure 6, Appendix A at 4. Thus there is no disclosure of the date of purchase or the price paid/recorded for the assets.

³⁶ See AT&T First Verizon Audit Comments at 26; AT&T’s Second Verizon Audit Comments at 16.

³⁷ *Id.*

³⁸ BellSouth Audit Response at 2.

³⁹ *Id.*

⁴⁰ BellSouth Audit Response at 2.

B. There Were Numerous Violations Of The Transactional Safeguards

1. “Transactions On An Arm’s Length Basis.”

The Auditor’s Report identified numerous violations of the transactional safeguards. As a threshold matter, BellSouth’s written policies and procedures were deficient. As noted by the Auditor, they had not been updated since 2001,⁴¹ and at least three section 272 requirements had not been included.⁴² In addition, the limited number of employee interviews that the Auditor conducted to test whether or not they were familiar with the affiliate transaction rules was also deficient. Bell Decl. ¶ 14.

There were also numerous web-posting violations, including delays in posting and inadequate disclosures, often involving the same agreements. Over a third of “34 written agreements, including their corresponding 64 amendments and addendums” were not posted to the website within the required 10 days,⁴³ and over a quarter of those agreements did not contain required disclosures, or there were differences between the agreement and what was posted on the website.⁴⁴

For example, the 1997 Facility Use Agreement, had a different execution date than that posted on the web and BellSouth guessed/estimated it was posted 5 months after it was

⁴¹ Objective V/VI, Procedure 5, Appendix A at 12 and Appendix B at 70.

⁴² *Id.* at 12-13. The requirements related to: (i) asset transfers, (ii) exchange and exchange access services and unbundled network elements, and (iii) interstate rate base, revenue requirements, and price cap indices of the BOC. The failure to include this last requirement is particularly notable in light of BellSouth’s claim that price cap regulation “alleviates” its incentives to misallocate costs. BellSouth’s Comments, Operate Independently NPRM, WC Docket No. 03-228 (Dec. 10, 2003) at. 8-10. In fact, price caps are not effective in preventing the cost misallocation of concern here, *see* AT&T’s Comments, Operate Independently NPRM, WC Docket No. 03-228 (Dec. 10, 2003) at 23-26 and Selwyn Decl. ¶¶ 13-14.

⁴³ Objective V/VI, Procedure 5, Appendix A at 17-19 and Tables 7-11.

⁴⁴ *Id.* at 16, Table 6 and 19-20.

executed.⁴⁵ The 1997 agreement also did not contain the required disclosure of whether the hourly rate is a fully loaded rate, and whether that rate includes the cost of materials and all direct or indirect miscellaneous and overhead costs for goods and services provided at FDC.⁴⁶ The 1999 Facilities Use agreement and its 23 amendments were not posted for up to four years after their execution date.⁴⁷

In addition, several sections of the InterLATA End to End Test Agreement posted on the web did not include text from the original agreement. This included “some additional testing locations and a statement that the number of PIC change orders to be processed may be increased upon mutual agreement of the parties.”⁴⁸ A separate End-to-End Test Agreement and five of its amendments were all posted on the web in December 1998, between 6 and 18 months after the execution date of those agreements.⁴⁹

⁴⁵ *Id.* at 16 and 18 and Table 8.

⁴⁶ *Id.* at 19-20.

⁴⁷ *Id.* at 17-18 and Table 7. The agreement itself was not posted until March 25, 2003. Amendments 1-11, some dating as far back as January, 1999, were not posted until May 2001 and Amendments 12-24 were not posted until February 14, 2003 although some dated as far back as September 2001. BellSouth argues that the 1997 Facilities Use Agreement was the “primary document [that] established BST’s willingness and obligation to provide testing activity” had been posted, and that the 1999 Agreement, and the amendments thereto, “were secondary documents . . . specifying the particular testing to be undertaken on a given project.” But of course, information regarding the particular testing to be undertaken on a given project is critical information to an unaffiliated carrier in any determination as to whether to inquire and obtain such testing services.

⁴⁸ *Id.* at 16, Table 6 and Letter from Stephen L. Earnest, BellSouth, to Terry Bowling, PricewaterhouseCoopers, BellSouth’s Audit Response at 6 (BellSouth explained that the Contract Manager was given an incorrect or incomplete electronic version of this agreement and its amendments and therefore the documents posted to the Internet were incorrect).

⁴⁹ Objective V/VI, Procedure 5, Appendix A at 18 and Table 8.

Similarly, a 2001 “Coordination Agreement” and a 1998 “Contract Usage for Daily Usage File” were not posted in a timely manner.⁵⁰ The Auditor also noted differences between the web postings and the agreements in comparing the current (2003) and the prematurely terminated (2000) Billing and Collection Agreements.⁵¹ These agreements also did not contain the required disclosure of whether the hourly rate is a fully loaded rate, and whether that rate includes the cost of materials and all direct or indirect miscellaneous and overhead costs for goods and services provided at FDC.⁵²

Indeed, 21 agreements did not contain the required disclosure of whether the hourly rate is a fully loaded rate, and whether that rate includes the cost of materials and all direct or indirect miscellaneous and overhead costs for goods and services provided at FDC,⁵³ including not only those noted above, but also the Affiliate Long Distance Service Agreement pursuant to which BSLD provides Corporate Communications to BST⁵⁴ and the Regulatory, Legal and Other Services Agreement.⁵⁵ BellSouth represented that these services were subject to the “prevailing price loophole”⁵⁶ and “are provided by BST, the BOC, to BSLD without regard to consideration

⁵⁰ *Id.* at 17-19, Tables 7 (Coordination Agreement, over one month) and 9 (Contract Usage for Daily Usage File, post date unknown).

⁵¹ *Id.* at 16, Table 6; *see also, id.* at 15, Table 5.

⁵² *Id.* at 19.

⁵³ *Id.*

⁵⁴ *Id.* at 22.

⁵⁵ The BOC and its section 272 affiliate were allowed to share regulatory, legal and other services subject to the “arm’s length” requirements.

⁵⁶ The “prevailing price loophole” is created by virtue of 47 C.F.R. § 32.27 which provides in subsection (c) that non-tariffed services that qualify for prevailing price valuation will be recorded in the revenue accounts at the prevailing price, and in subsection (d) that all service transactions subject to section 272 of the Act qualify for prevailing price.

of Fully Distributed Cost (FDC).”⁵⁷ But the Commission has made it clear that disclosures about the hourly rate are required.⁵⁸

2. “Valuation Methodology”

There are problems with BellSouth’s valuation methodology as well. For services provided by BST to BSLD, BST charged BSLD for joint marketing at a Fair Market Value (“FMV”) that was “determined through an independent valuation, performed by Boston Consulting Group, based on existing arm’s-length sales agency relationships”⁵⁹ but because FDC is higher, a true-up was done at the end of the year.⁶⁰ However, it is not clear from the audit that a *bona fide* FMV might not have been higher than FDC. No details about the compared services are provided. Moreover, “none of the 9 invoices [with the FMV charges] contained unit charges.”⁶¹ Had the unit charges been included, a more accurate FMV could have been calculated.

With respect to the Corporate Communications services (involving interstate access, intrastate access and international access) provided by BSLD to BST,⁶² the Auditor did not even identify the “independent consultant” who performed the FMV analysis. For international access, the sampling was inadequate for the reasons set forth by Dr. Bell, Bell Decl. ¶ 15. Combined

⁵⁷ Objective V/VI, Procedure 5, Appendix A at 20.

⁵⁸ *Second BellSouth Louisiana Order*, 13 FCC Rcd at 20790-95 (for affiliate transactions involving services, the BOC should disclose whether the hourly rate is a fully loaded rate, and whether or not that rate includes the cost of materials and all direct or indirect miscellaneous and overhead costs).

⁵⁹ Objective V/VI, Procedure 5, Appendix A at 21.

⁶⁰ The “true up” was to FDC so that, in compliance with the affiliate transaction rules, BSLD is charged the higher of FDC or FMV. *Id.*

⁶¹ *Id.*

⁶² See text accompanying note 55 *supra*.

with the “numerous errors” identified by the Auditor, the international access data reported is meaningless.⁶³ The interstate and intrastate portion of the data for Corporate Communications is also suspect because: (i) for almost half (57/118 or 48%) of the sampled invoices, the amount recorded in BST’s books for Corporate Communications did not agree with the amount BST paid to BSLD and (ii) for 42 of those 57 invoices (or almost 75%), the Auditor was unable to compare the invoiced amount to the amount BST paid.⁶⁴

III. OTHER POSSIBLE VIOLATIONS OF SECTION 272

1. Other Possible Violations of the Structural Safeguards

Two potential violations identified in Objective I (“Operate Independently” safeguard) should have been pursued by the Auditor. First, in auditing compliance of the joint ownership safeguard, the Auditor discovered that among the invoices improperly billed to BSLD were those involving circuit charges that had been initially capitalized and thus included on the list of assets, and which was subsequently expensed. The Auditor should have determined why the circuit charges were initially capitalized, and whether there was a *bona fide* transfer of assets now recharacterized as a sale of services.⁶⁵ Second, the Auditor found that BSLD had assets at a building owned/leased by BST that were subject to the Facility Use agreement.⁶⁶ As discussed above, to the extent this agreement involved testing provided to BSLD by BTAC, that testing

⁶³ Objective V/VI, Procedure 5, Appendix A at 24.

⁶⁴ *Id.*

⁶⁵ Compare, Complaint, *Touch America, Inc. v. Qwest, Communications International, Inc.*, File No. EB-02-MD-003 (Feb. 2002) (Qwest provided in-region interLATA service in violation of the *Qwest Merger Orders* and section 271 using dark fiber IRUs that it claimed were asset transfers -- to be capitalized – rather than leases or sales of service – to be expensed) and Consent Decree, In the Matter of Qwest, Communications International, Inc., EB-02-IH 0674 (rel. May 7, 2003).

⁶⁶ See Objective V/VI, Procedure 5. This is also the subject of Objective V/VI, Procedure 8.

may well have violated the “maintenance” portion of the prohibition on the provisioning of Operation, Installation and Maintenance Service.⁶⁷

Moreover, in prior audits, the *General Standard Procedures* have required the Auditor to use the general ledger to determine compliance with section 272. For example, in the most recent Verizon section 272 audit, the Auditor identified potential violations of sections 272(b)(1) and 272(e)(2) using the general ledger.⁶⁸ Here, the *General Standard Procedures* substituted the “balance sheet” for the general ledger for determining compliance with section 272(b)(1) (Objective I),⁶⁹ and although requiring the general ledger for Objective II (separate books, records, and accounts requirement),⁷⁰ the Auditor found the general ledger “too voluminous” and after comparing ten accounts from the trial balance with the General Ledger, used the trial balance instead. The substitution of the general ledger with the trial balance is unreasonable, and the Commission cannot conclude from the Auditor’s review of the trial balances that BellSouth is complying with its obligation.

Finally, with respect to section 272(b)(4)’s “no recourse” prohibition (Objective IV), when the Auditor sought confirmation of lack of recourse, only half of the creditors responded.⁷¹

⁶⁷ See text accompanying notes 32-33 *supra*.

⁶⁸ AT&T’s Second Verizon Audit Comments at 12, 15-16. For example, as to section 272(b)(1) (Objective I), the Auditor in the Verizon audit, compared the general ledgers with BOC’s list of assets and noted discrepancies between the two relating to “construction in progress.”

⁶⁹ *General Standard Procedures* at 22-23, Objective I, Procedure 6.

⁷⁰ *General Standard Procedures* at 24, Objective II, Procedure 1. Section 272(b)(2) requires an interLATA affiliate to “maintain books, records, and accounts in the manner prescribed by the Commission that are separate from the books, records, and accounts maintained by the Bell Operating Company of which it is an affiliate.” 47 U.S.C. § 272(b)(2).

⁷¹ Objective IV, Procedure 3, Appendix A at 8 (BSLD, 40/72); Objective IV, Procedure 3, Appendix B at 69 (BCPS, 4/8 creditors).

As noted in AT&T's prior Comments, no conclusions can be drawn as to compliance with this requirement when such a substantial proportion of creditors have failed to respond.

2. *Avoidance of the Transactional Safeguards Through Use of A "Central Service" Affiliate.*

BellSouth has created BellSouth Affiliated Services Corporation ("BASC"), "a centralized service entity"⁷² that *inter alia*, "processes disbursements and payable transactions for BSLD, BCPS and other affiliates,"⁷³ and provides "limited R&D 'retainer' services to BSLD with the potential for consultations on MPLS data architecture, voice over IP trials, and Advanced Intelligent Network capabilities."⁷⁴ BSAC thus may provide support services that the BOC typically provided. However, now that BSAC provides these services to the BOC and other BOC affiliates, BellSouth does not disclose the terms of the services provided – thereby avoiding the disclosure requirements under section 272 and the Commission's rules.

3. *Discriminatory Provision of Goods and Services*

As noted by Dr. Bell, there is insufficient information about the judgmental sample used to determine compliance with Objective VII.⁷⁵ Bell Decl. ¶ 16. Moreover, the reported data for transport services in Objective VII,⁷⁶ as well as the data for the sampled month of February 2003

⁷² BellSouth's Audit Response, response to Objective V/VI, Procedure 2 at 3.

⁷³ Objective IX, Procedure 3, Appendix A at 56.

⁷⁴ Objective I, Procedure 5, Appendix A at 3. BASC is also the "control point for all asset transfers that involve BST." BellSouth's Audit Response, response to Objective V/VI, Procedure 2 at 3. Procurement may also be performed by a separate organization within BellSouth, Supply Chain Services (SCS) which performs sourcing procurement. Objective VII, Procedure 1, Appendix A at 27.

⁷⁵ Auditing compliance by BellSouth with Section 272(c)(1)'s prohibition on the discrimination in the "provision . . . of goods, services, facilities and information."

⁷⁶ *E.g.*, the third listed exception item in Objective VII, Procedure 1, Appendix A at 28, *see* BellSouth's Response at 10.

for exchange access services in Objective IX⁷⁷ and Wholesale National Directory Assistance (“WNDA”) in Objective XI,⁷⁸ suggests that BellSouth may have structured certain preferentially priced transactions so that only its section 272 affiliate would qualify.⁷⁹

4. *Improper Imputation*

The Auditor also found a surprising number of calculation errors in auditing compliance with BellSouth’s imputation obligation,⁸⁰ suggesting possible non-compliance with this requirement. For National Directory Assistance, the tariff rates did not match the rates that were being applied for the months of June-November 2002 and March, 2003 (7/12 months).⁸¹

Numerous “calculation” errors were also found for E911 services requiring adjustment entries of

⁷⁷ Objective IX, Procedure 2, Appendix A at 55. Objective IX audits compliance by BellSouth with Section 272(e)(2)’s prohibition on discrimination in the provision of exchange access facilities or services.

⁷⁸ Objective XI, Procedure 2, Appendix A at 61. Objective XI audits compliance by BellSouth with Section 272(e)(4)’s prohibition on discrimination in the provision of interLATA or intraLATA facilities or services. For WNDA 25% of the billed items (11/44) were on different pricing plans or were priced differently because of differential Percentage Interstate Usage, and in all these cases it was the section 272 affiliate which qualified for the lower rates. Moreover, over one third (16/44) were in Florida and North Carolina where BSLD was the only IXC to purchase WNDA.

⁷⁹ The practice of structuring transactions so that only the section 272 affiliate can practically subscribe to it, and then preferentially pricing the services subject to that arrangement using the “prevailing price loophole,” is explained more fully in AT&T’s filings in the OI&M forbearance proceedings, *See* Letter from Aryeh Friedman, AT&T, to Marlene Dortch, FCC, *Verizon OI&M Forbearance Proceeding* (October 1, 2003) at 5-6; Letter from Aryeh Friedman, AT&T, to Marlene Dortch, *SBC OI&M Forbearance and Modification Proceeding*, CC Docket No. 96-149, 98-141 (October 27, 2003) at 8; Comments of AT&T Corp., WC Docket No. 02-150, at 47-51 (filed July 11, 2002) (“AT&T Alabama 271 Comments”) (BellSouth proposed a tariff that would establish a discriminatory growth discount that would favor BellSouth’s long distance affiliate over large, established IXCs such as AT&T). That such plans may also include a few of the BOC’s smaller, weaker competitors does not negate the fact that they are designed so that most unaffiliated carriers could not practically subscribe to them.

⁸⁰ Section 272(e)(3) requires that BOCs not discriminate with respect to the amount charged or imputed for access to telephone exchange and exchange access.

⁸¹ Objective X, Procedure 2, Appendix A at 58.

\$1 million in 2002 and \$2.1 million in 2001.⁸² There were “input and mathematical” errors in the mileage portion of the calculation, and the amount recorded in the general ledger for one state was approximately \$171,000 less than the adjusted imputation amount calculated for 2002.⁸³ Finally, for reverse search services, the amount in the general ledger was \$8,000 less than the imputation amount calculated for the period under review.⁸⁴

CONCLUSION

For the reasons stated, the Commission should penalize BellSouth for its patent violations of section 272, and require re-audit of those items where insufficient inquiry was made by the Auditor.

Respectfully submitted,

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March 9, 2004

⁸² *Id.*

⁸³ *Id.*

⁸⁴ *Id.*

CERTIFICATE OF SERVICE

I hereby certify that on this 9th day of March, 2004, I caused true and correct copies of the forgoing Comments of AT&T Corp. on BellSouth's Section 272 Compliance Biennial Audit Report to be served on all parties by mailing, postage prepaid to their addresses listed on the attached service list.

Dated: March 9, 2004

/s/ Karen Kotula

Karen Kotula

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